

DOCKET FILE COPY ORIGINAL

ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

RECEIVED

AUG 6 1999

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)
Annual Assessment of the Status of)
Competition in the Market for the)
Delivery of Video Programming)

CS Docket No. 99-238

COMMENTS OF OPTEL, INC.

OpTel, Inc. ("OpTel"), submits these comments in response to the Notice of Inquiry ("NOI") in the above-referenced proceeding. OpTel, through subsidiaries, operates private cable/telecommunications systems and franchised cable systems that provide service to hundreds of thousands of homes in nine major U.S. cities.

DISCUSSION

In the NOI, the Commission has asked commenters to identify specific rules and policies that should be "reexamined in light of current competitive opportunities within multichannel video programming markets."¹ To assist in developing this information, the Commission has asked a number of specific questions. OpTel herein responds to those of the questions that relate most directly to OpTel's efforts to compete in the MVPD MDU submarket.

1. "How common is it for consumers to have choices among MVPD services within a particular MDU?"

This question seeks to address the consumer welfare implications of MVPDs competing to serve MDUs as opposed to competing within MDUs for the business of individual residents. For a variety of reasons having to do with the number of MVPDs property owners will allow to overbuild a property, the costs of constructing cable facilities within MDUs, and the difficulty of attracting multiple MVPDs without offering exclusive arrangements (see below), it is extremely unlikely that consumers within MDUs will have competitive choices among MVPDs within an MDU. There continues, however, to be a growing array of competitors seeking to serve MDUs.

¹ NOI ¶ 5.

No. of Copies rec'd 0+9
List ABCDE

In this regard, the MDU MVPD submarket is little different from the single-family home submarket. With the exception of the odd franchise overbuilder, most people, no matter where they reside, have little choice between or among multiple MVPDs using coaxial cable or other closed path transmission facilities.

With respect to competition to serve MDUs, however, there is a growing number of MVPDs, such as OpTel, that specialize in serving MDUs,. In many cases, providers who specialize in serving MDU residents seek to do so on an exclusive basis. Of course, because of the Commission's OTARD rules,² there are no truly "exclusive" MDU contracts. Residents of MDUs often can, notwithstanding such "exclusive" agreements, install their own reception equipment on the part of the MDU premises that they own or occupy to receive video programming.

Nonetheless, for a new MVPD entrant, the availability of an exclusive right-of-entry agreement for any MDU property is a significant factor in the decision to build network to serve the property. There simply is no viable business case for building a state-of-the-art network to an MDU property to serve only one or a few subscribers at the property.

Exclusive right-of-entry agreements normally are awarded as a result of a competitive bidding process or other competitive selection process. Thus, although individual subscribers at any particular MDU property may not have a choice between, for example, OpTel's service and that of the incumbent franchised cable operator, OpTel and others (including the incumbent operator) almost certainly (unless the cable operator has a "perpetual" agreement) had to compete for the opportunity to provide service to the MDU in question.

The question then that should be asked, from a consumer interest perspective, is whether property owners and managers who choose among the various providers seeking to serve MDUs are making decisions in the best interests of their residents. OpTel's experience is that — in the vast majority of cases — MDU owners are interested in providing their residents with the highest quality services at the best possible rates.³ Competitive bidding by MVPDs for an exclusive right-of-entry helps them to achieve that end.

² Restrictions on Over-the-Air Reception Devices: Television Broadcast, Multichannel Multipoint Distribution and Direct Broadcast Satellite Services, 13 FCC Rcd 23874 (1998).

³ Indeed, in many cases, the person or group negotiating an MVPD agreement for the residents of an MDU has been elected by the residents (*e.g.*, in condominium and co-ops). In other cases, (*e.g.*, at rental

Naturally, there are exceptions and, on occasion, OpTel has been refused access to a property for reasons unrelated to the quality or price of services that it would provide to residents. Such instances are the exception rather than the rule, however. In most cases, the ability of an MDU owner or manager to negotiate on behalf of all residents through an exclusive arrangement allows the MDU owner to attract new MVPD entrants and competitive service offerings. Any limit on the ability of MDU residents to wield their collective buying power through exclusive agreements, therefore, would be anti-consumer and anti-competitive.

2. "How do program offerings and prices charged by MVPDs serving MDUs compare?"

OpTel's right-of-entry agreements almost always are tied to its commitment to provide — throughout the term of the agreement — competitive services and features at a price that is equal to or less than that generally available in the market. Failure to abide by this covenant can be an event of default, ending OpTel's service rights on the property. To meet its contractual obligations, OpTel has upgraded, at substantial capital expense, the network and wiring to approximately 70% of all the units that it serves.

3. "Are MVPDs providing multiple services to MDU customers?"

Private cable operators, led by OpTel, now are able to offer to subscribers in MDUs an integrated package of communications services at competitive rates. OpTel's service offerings include: (1) basic and premium video programming services, and in some areas an additional tier of direct broadcast satellite ("DBS") programming; (2) a full-featured switched local and long-distance telephone offering; (3) high speed Internet access via cable modem with downstream transmission speeds of up to 1.5 MB per second.

Video. OpTel offers its subscribers a full range of popular video programming at competitive prices. OpTel's networks are capable of delivering up to 72 uncompressed analog channels of programming. OpTel's basic video programming package provides an extensive channel selection featuring all major cable length motion pictures, sporting events, concerts, and other entertainment programming. In addition, the programming selections available at any MDU served by OpTel's microwave networks can be tailored on a sub-market basis to meet local needs and

properties), the MDU owner or manager is constrained by the extremely competitive residential real estate market.

preferences. To enhance its video programming offerings, OpTel has made arrangements with a distributor of DBS programming services to allow it to receive programming via DBS, and to provide DBS programming packages to its subscribers.

Voice. In markets in which it operates its own central office switch, OpTel provides local exchange telephone service, including standard dial tone access and substantially all other feature groups provided by the incumbent local exchange carriers ("ILECs"). OpTel offers a wide range of value-added services, including call forwarding, call waiting, caller identification, conference calling, speed dial, calling card, 800-numbers, and voice mail. OpTel generally prices its local telephone offering at a discount to the ILEC rates in each of its serviced markets. OpTel provides long-distance services, including outbound, inbound, and calling card services, through a resale arrangement with a large national interexchange carrier. OpTel also contracts or plans to contract for other ancillary services, including operator service, directory assistance, emergency 911 services and, in certain markets, transport services.

High Speed Internet Access. OpTel has initiated a cable modem-based high speed Internet access service in its Houston, Dallas-Fort Worth, San Francisco, and Denver markets in conjunction with an unaffiliated ISP. OpTel intends to roll-out its high speed Internet access service in substantially all of its markets over the next twelve to eighteen months. OpTel's Internet access service offers customers a choice of transmission speeds ranging from approximately 64 kilobits per second to 1.5 megabits per second, which compares to speeds achieved using Integrated Services Digital Network ("ISDN") and Digital Subscriber Line ("DSL") services.

4. "Is the use of exclusive service contracts increasing or decreasing?"

OpTel has no basis to comment on whether the use of exclusive MVPD contracts is increasing or decreasing. However, non-incumbent MVPDs have a much better chance of survival if they are able to obtain exclusive right-of-entry agreements for the properties they serve.

When a new entrant seeks to compete in any MVPD sub-market, the incumbent operator enjoys a number of advantages. Among other things, subscribers are familiar with the name of the incumbent, the incumbent typically has a fully built-out system — paid for by captive subscribers — and the incumbent continues to have a competitive "cushion" of subscribers in less competitive segments of the geographic market. Incumbents also typically are able to obtain programming at substantially discounted

rates and they often have existing relationships with state and local government bodies with regulatory authority over some aspects of would-be competitors' networks.

Moreover, because of the Commission's recent decision to allow franchised cable operators to offer "bulk" discounts to residents of MDUs on an individual basis,⁴ incumbent operators now are better able to leverage these advantages when a new entrant seeks to serve any one MDU or group of MDUs in the incumbent's franchise area. To the extent that the new entrant would consider competing on a subscriber-by-subscriber basis in the MDU(s), it now must allow for the fact that the incumbent may respond to the competitive threat by offering subscribers targeted discounts.

For all of these reasons, the prospect for success of a new entrant competing on a unit-by-unit basis in an MDU is dim. More importantly, it is difficult, if not impossible, to attract private investment in such an effort. By contrast, the ability to sign-up a group of subscribers over a period of years helps new entrants to attract capital and deploy network resources. Thus, the use of exclusive arrangements by new entrants at MDUs helps to enhance the level of competition in the MVPD markets.

5. "How many exclusive contracts are perpetual?"

As explained above, exclusive contracts for MVPD services normally are pro-competitive.⁵ However, exclusive arrangements do present a competitive problem when they result from an exercise of market power.

In a free market, where MDU owners are competing for residents and MVPDs are competing to provide service to MDUs, one would expect, and OpTel finds, that the parties to an exclusive MVPD agreement will bargain to a mutually beneficial outcome: residents will get high-quality services at competitive rates, MDU owners are able to increase the marketability of their units, and MVPDs are able to attract the investment required to build-out systems and compete with the incumbent operators. In those circumstances one would not expect MDU owners to acquiesce to contract terms that provide for a "perpetual" MVPD right-of-entry and, indeed, in today's market, new perpetual right-of-entry agreements are rare.

⁴ In The Matter Of Implementation Of Cable Act Reform Provisions Of The Telecommunications Act Of 1996, CS Docket No. 96-85 (rel. Mar. 29, 1999).

⁵ See Prof. Michael D. Whinston, Report on the Competitive Effects of Exclusive Contracting for Video Programming Services In Multiple Dwelling Units (Mar. 2, 1998) (attached).

Nonetheless, numerous pre-existing perpetual right-of-entry agreements still are being enforced. These contracts are the product of a time when there were no significant competitors to franchised cable — if an MDU owner wanted multichannel video service, he or she had no choice but to accept the terms and conditions offered by the cable operator. Thus, perpetual contracts rarely, if ever, include service standards such as those found in modern exclusive contracts, and they normally provide that the franchised cable operator will own the inside wiring in perpetuity. In some areas — notably Southern California, Phoenix, Arizona, and Southern Florida — large segments of the MDU market are foreclosed to competitive entry by perpetual right-of-entry agreements.

6. **“Are there factors that are unique to the MDU market that have consequences for regulatory policy?”**

MDU Residents Should Be Permitted To Wield Their Collective Buying Power. The campaign by the franchised cable interests to portray MDU owners and managers as “gatekeepers” lining their pockets at the expense of MDU residents should be seen for what it is — an effort to preserve and maintain the existing monopoly that franchised cable operators continue to hold in most local MVPD markets. The bargaining power that MDU residents now wield through their representatives has allowed them to attract competitive entry, which is a threat to the incumbent monopolists.

For the most part, MDU owners and managers bargaining on behalf of their residents have helped to create a competitive environment in which there are numerous service providers competing to provide high quality cable, Internet, and telecommunications services to MDUs. The Commission, in developing new rules and policies, and in enforcing the old, should be careful not to impede the growth of competition in this segment of the market by limiting residents’ right to exercise collective buying power.

The Commission’s Pro-Competitive Inside Wiring Transition Procedures Are Being Frustrated By The Franchised Cable Monopolists. Franchised cable operators continue to take advantage of their status as incumbents to thwart competitive entry. A recent case involving Charter Communications Entertainment II, LLC (“Charter”) is indicative of the conduct new entrants face when seeking to provide competitive multichannel video services to an MDU.

By way of background, OpTel and the owner of Falls Creek Apartments ("Falls Creek") in Alta Loma, California, entered into an agreement for OpTel to provide multichannel video services to Falls Creek. Falls Creek is served by American Cable Entertainment Company, which recently was acquired by Charter and is referred to herein, for the sake of simplicity, as "Charter." In response to notices from the owner and OpTel that the owner had contracted for OpTel to provide multichannel video services and granted OpTel the right to use the existing wiring on the property, Charter asserted that it owns all existing wiring and equipment on the premises and that it has a permanent right to provide cable television services to the apartment complex.

When the owner insisted that Charter provide evidence of its claimed rights, Charter responded with a letter to the owner in which it both threatened legal action against the owner and, "in order to avoid the costs and expenses of prolonged litigation," invited the owner to enter into a new, long-term service agreement with Charter in exchange for "substantial compensation."

In an effort to bring about an orderly transition of cable service, and even though Charter can produce no evidence that it owns the inside wiring at the Falls Creek Apartments, OpTel and the owner each sent notices to Charter invoking the procedural mechanisms of the FCC's inside wiring rules (which apply when the incumbent operator does, in fact, own the inside wiring). In response, Charter argued that it does not have to comply with the FCC's rules because it claims a permanent right to provide cable service to the property.

Charter has advanced many specious theories in support of this claim, including: (1) that it holds a cable television franchise, which, in combination with Section 621(a)(2) of the Communications Act of 1934, gives it the right to use easements granted to utilities for utility service — an argument that has been rejected by every court that has addressed it, including the 9th Circuit;⁶ (2) that it has somehow acquired an "irrevocable license" to serve the property — a position for which there is no legal basis; and (3) that it has an agreement with a utility to use the utility's easements — which, if true, involves an unauthorized and, as discussed in a recent FCC Notice of

⁶ See Century Southwest Cable Television, Inc. v. CIIF Associates, 33 F.3d 1068 (9th Cir. 1994).

Proposed Rulemaking, an unlawful expansion of the utility's easements under current law.⁷

Charter now has filed a lawsuit against OpTel and the owner of the Falls Creek Apartments in which Charter continues to advance these arguments in an effort to thwart the application of the FCC's inside wiring rules. These tactics, which are typical, obstruct competitive entry and cause both competitive MVPDs and owners of MDUs to incur substantial legal expenses.

The Commission's Microwave Rules Should Not Favor The Incumbent Monopolists. Private cable systems typically use an 18 GHz microwave architecture to compete directly with incumbent franchised cable operators. The 18 GHz band, however, suffers from technical limitations relating to the propagation characteristics of transmissions at these frequencies. Further, recent and proposed regulatory changes threaten to impair the use of the band for private cable services.⁸

For these reasons, OpTel petitioned the Commission to open the 12 GHz CARS band, which is used by franchised cable operators to deliver video programming material, for use by non-franchised MVPDs.⁹ 12 GHz microwave facilities have double the range of 18 GHz microwave and they are not affected by the new and proposed regulatory changes that are threatening the 18 GHz band.

The Commission now has adopted a Notice of Proposed Rulemaking seeking comment on OpTel's petition. The Commission should move quickly to resolve that item and open the 12 GHz band to cable competitors. There simply is no basis for an eligibility restriction that favors the incumbent monopolists. By opening the 12 GHz CARS band to private cable and other non-franchised MVPDs, the Commission would enhance competition in the local MVPD markets, promote more efficient use of the radio spectrum and, generally, satisfy its obligation to "encourage the larger and more effective use of radio in the public interest."¹⁰

⁷ See Promotion of Competitive Networks, WT Docket 99-217 (rel. July 7, 1999) ¶¶ 44-45 (seeking comment on the ramifications of allowing/requiring utilities to make easements on private property available to third parties).

⁸ See In the Matter of Amendment of the Commission's Rules to Relocate the Digital Electronic Message Service from the 18 GHz Band to the 24 GHz Band, ET Docket No. 97-99 (rel. Oct. 14, 1997); Redesignation of the 17.7-1.7 GHz Frequency Band, IB Docket No. 98-172 (rel. Sept. 18, 1998).

⁹ OpTel Petition For Rulemaking, RM-9257 (filed Apr. 1, 1998).

¹⁰ 47 U.S.C. § 303(g).

7. "Which are the largest SMATV operators and have they been forming alliances with DBS providers?"

To begin with, non-franchised operators providing MVPD services to MDUs are not necessarily SMATV systems. SMATV systems receive their signal feed at a head-end on the property being served and distribute it without enhancement to the individual units on the property. Modern private cable systems, such as those operated by OpTel, aggregate head-end, telecommunications, and other facilities at a single site and deliver an integrated package of services to multiple MDU properties using a variety of delivery technologies, often including one or more microwave links.

Among private cable providers, OpTel is a market leader. Based on the latest study done by *Broadcasting & Cable*, OpTel's subscriber base would place it among the top 25 cable MSOs if it were operating franchised systems exclusively.¹¹ To augment its own video programming package, OpTel has entered into an agreement with EchoStar that provides OpTel with the right to order and receive, on behalf of OpTel's MDU customers, EchoStar's DISH Network DBS programming. At those locations that OpTel has offered this service, its basic and expanded basic cable customers may select any one or more of DISH Network's programming services or packages as additional tiers. DISH Network's digital service offers CD-quality audio and high-quality video channels providing over 300 programming services consisting of local, national and international video and music entertainment.

8. "Is the coverage of the program access rules appropriate?"

As the Commission well knows, vertically integrated cable MSOs have inordinate control over the most popular programming. Many of the most popular cable networks are affiliated with a cable MSO and, even when they are not, franchised cable operators exercise monopsony buying power, which allows them considerable influence over whether the programmer makes its programming available to competing MVPDs.

Congress and the Commission have sought to address this market failure. In 1992, Congress adopted Section 628 of the Communications Act, which forbids certain anticompetitive programming practices, and which provides a "clear repository of Commission jurisdiction to adopt additional rules or to take additional action to

¹¹ See Top MSOs Own 90% of Subs, *Broadcasting & Cable* (May 24, 1999) at 34.

accomplish the statutory objectives.”¹² Since that time, the Commission has adopted a number of rules and policies designed to “accomplish the statutory objective” of combating anticompetitive programming practices. Nonetheless, the current protections contain several significant flaws.

First, the Commission’s program access rules do not provide for damage awards against parties found in violation of those rules. As OpTel has noted in the past, without the possibility of an award of damages, there is little practical incentive to pursue a remedy at the Commission, nor is there any real deterrent effect on programmers who would violate the rules.¹³

Second, discriminatory pricing in the programming market is widespread. In OpTel’s experience, the cost of programming, on a per-subscriber basis, for new entrants in the MVPD market is many times that for the large cable MSOs. When challenged, however, programmers allege a cost basis for the discriminatory pricing, which can be facially defended under the Commission’s rules. In fact, although up-front costs in the production of programming can be quite high, the marginal cost of distributing programming normally is relatively low. The Commission should, therefore, require a strict cost justification for any discount offered to MSOs that is not offered to new MVPD entrants. If the cost justification rules were more demanding of programmers, discriminatory pricing would be far less common.

Finally, as numerous parties have noted in other contexts, Section 628 contains loopholes that should be closed. Section 628 (and therefore the Commission’s implementing rules) does not cover non-satellite-delivered programming or programming provided by non-vertically integrated programmers. These loopholes continue to be exploited and the resulting discrimination in programming practices continues to impede the development of competition in the MVPD markets.

CONCLUSION

The Commission has made great strides in its efforts to promote MVPD competition. Considerable work remains to be done however. Most importantly, the Commission must recognize that new MVPD entrants do not have market power and it should avoid heavy-handed regulations that treat new entrants as if they do. On the

¹² E.g., Matter of Dakota Telecom, Inc. CSR-5381-P (rel. July 1, 1999).

¹³ See Implementation of the Cable Television Consumer Protection and Competition Act of 1992, CS Docket No. 97-248, Comments of OpTel (filed Feb. 2, 1998).

other hand, the existing monopoly power of incumbent franchised cable operators continues to distort the marketplace. Where the Commission has been asked to check this monopoly power, it should not be slow to act.

Respectfully submitted,

OPTEL, INC.

A handwritten signature in black ink, appearing to read "W. Kenneth Ferree", written over a horizontal line.

/s/ W. Kenneth Ferree

Henry Goldberg

W. Kenneth Ferree

GOLDBERG, GODLES, WIENER & WRIGHT

1229 Nineteenth Street, NW

Washington, DC 20036

(202) 429-4900

Its Attorneys

August 6, 1999